

Senator Larry Rhoden, Chair
Representative Justin Cronin, Vice Chair

Second Meeting
2014 Interim
September 15, 2014

Room 413
State Capitol
Pierre, South Dakota

Monday, September 15, 2014

Senator Larry Rhoden called to order the second 2014 interim meeting of the Legislative Research Council Agricultural Land Assessment Implementation and Oversight Advisory Task Force at 10:30 a.m. (CT), September 15, 2014, in Room 413 of the State Capitol, Pierre, South Dakota.

A quorum was determined with the following members answering the roll call: Senators Larry Rhoden, Chair, Jason Frerichs (via telephone), and Al Novstrup; Representatives Justin Cronin, Vice-Chair, Julie Bartling, and Jim Peterson; Walt Bones, Kirk Chaffee, Paul Dennert, Curt Everson, Tom Hansen, and Lyle Perman. Members excused were Senator Billie Sutton and Representative Mark Mickelson.

Staff members present included Fred Baatz, Principal Research Analyst; Amanda Jacobs, Research Analyst; and Rena Ortbahn, Secretary.

NOTE: For purpose of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents distributed at the meeting are attached to the original minutes on file in the Legislative Research Council (LRC) and some documents can be found on the LRC website at: <http://legis.sd.gov/Interim/CommitteeDocuments.aspx?Session=2014>.

Approval of Minutes

MR. CURT EVERSON MOVED, SECONDED BY MR. KIRK CHAFFEE, TO APPROVE THE MINUTES OF THE JULY 22, 2014 MEETING. The motion prevailed unanimously on a voice vote.

Opening Remarks

Senator Larry Rhoden said the purpose of this meeting is to discuss the issues of actual use, conservation easements, school district capital outlay, and agricultural property classifications and provide a direction to staff in developing legislation. He wants to avoid any duplication in proposed legislation between this task force and the Governor's work force.

Representative Jim Peterson said the substantial recent growth in the school district capital outlay tax is putting a tremendous burden on agriculture property which this committee, along with the Governor's Work Force, needs to address.

Ag Land Assessment – Factors for Determining Agricultural Income Value

Dr. Burton Pflueger, Economics Department, South Dakota State University spoke to the task force about the landlord share factor and the capitalization rate or multiplier (**Document #1**).

Dr. Pflueger recommended, after reviewing several sources of data for South Dakota and the surrounding states, that there be no change in the present landlord share factor of 35%. Dr. Pflueger

also recommended that the capitalization rate or multiplier of 6.6% remain unchanged, at this time. Both are factors used for determining agricultural income value and ultimately the individual's property tax assessment.

Senator Rhoden, on behalf of the task force, thanked Dr. Pflueger for his expertise and assistance and the information he has provided them throughout the years.

SDSU Economics Department Introductions

Dr. Eluned Jones, Department Head, Economics Department, South Dakota State University, introduced Dr. Matthew Elliott as a new department Assistant Professor. **Dr. Matthew Elliott** briefly reviewed his professional background. Dr. Elliott will be working with the Department of Revenue and the task force concerning the productivity valuation system model.

Classifying Property as Agricultural Land – Review of Surrounding States

Fred Baatz, Principal Research Analyst, Legislative Research Council spoke to the task force. He introduced Amanda Jacobs, a recently hired LRC Research Analyst.

Mr. Baatz provided the task force with information on how surrounding states and also Colorado, classify agricultural property (**Document #2**). He reviewed how these states define ag purpose, set acreage and income requirements, and deal with contiguous and non-contiguous property. He pointed out that some terms found either in South Dakota or other state's statutes could be open to interpretation.

Mr. Baatz responded to committee questions. He said other state's minimum agricultural income criteria are generally set low and he didn't find major requirements on acreage size. He also said some states use market and others use a productivity valuation system. Montana has acreage criteria similar to South Dakota's, but other states had minimum acreage criteria, if any. A number of states also used statutory language that reflects more subjective criteria such as: devotes a major portion of time to producing ag products, actively devoted to ag use, bona fide ag operation, ag land which in good faith used primarily for ag purposes; and primary purpose of obtaining a monetary profit.

Senator Rhoden found it interesting that growing timber is not an ag use in Montana.

Senator Rhoden said that the tax assessment of small ag operations is an issue. If small operations lose their ag classification, the resulting tax assessment will be substantially larger. He said it's an issue for which the committee should discuss a solution and he asked that the ag organizations also provide input.

Review of Bills introduced in the Past

Mr. Baatz reviewed the following bills which were introduced and failed to pass in previous sessions:

- House Engrossed No. HB 1097, An act to revise the criteria for classifying property as agricultural land. 2014 Legislative Session (**Document #3**).
- Senate Engrossed No. HB 1009, An Act to create additional classifications of agricultural property, to revise certain provision concerning the valuation of agricultural land for ad valorem taxation, and to revise certain provision concerning the taxation of certain agricultural property. 2006 Legislative Session (**Document #4**).
- Senate Bill No. 8, An Act to revise certain provisions concerning the assessment and taxation of real property. 2014 Legislative Session (**Document #5**).

Senator Rhoden stated that revising the criteria for classifying property is a complicated issue, any changes may have unintended consequences, and the task force should focus on the current assessment process.

Mr. Baatz said that SB 8 tried to extend controls on school district levies authority beyond 2015 to 2019 for certain school districts experiencing large growth in assessments. He said if nothing is done, the tax limitations will end in 2015. He said the impact is most significant for school districts with a large agricultural valuation presence.

Senator Rhoden said that task force recommendations as to legislation may be influenced by the Governor's work force recommendations concerning school tax levies.

Mr. Tom Hansen said school districts may levy taxes for capital outlay, retirement, and special education. The capital outlay tax has had a significant impact on the ag sector. There should have been limited amount of dollars from taxpayers for capital outlay. The situation is compounded in that non-cap expenses are being paid out of capital outlay tax revenue.

Senator Rhoden recessed the committee at 11:50 a.m. and reconvened it at 1:15 p.m.

Ag Land Assessment and Easements

Mr. Michael Houdyshell, Director, Division of Property and Special Taxes, SD Department of Revenue, spoke to the committee.

Mr. Houdyshell said the Governor's Work Force is reviewing the capital outlay levy and other revenues that schools receive. A work force sub-committee is looking at summarizing the discussions, addressing the issues, and submitting a proposal to larger group.

The Governor's work force has a goal of limiting capital outlay growth in agriculture. He said it has increased in recent years primarily because of productivity and increased valuations. The work force has found a direct correlation between growth in total valuations and growth in cap outlay. Capital outlay taxes have doubled since 2003, and if nothing is done they will probably double again within the next ten years.

Senator Jason Frerichs had previously requested further information on conservation easements. Mr. Houdyshell said the task force covered the issues of conservation easements in depth in the 2012 interim. He said the Department of Revenue can find nothing in present state statute permitting allowances solely for conservation easements.

He referred to a handout that summarizes the 2012 interim task force's suggestions for legislative fixes to allow for adjustments for conservation easements on lands with crop-rated soils (**Document #6**). The suggestions involved making adjustments based on the soil type, making straight percentage adjustments, or possibly placing a time trigger on any adjustments made.

He said in making conservation easement allowances one should consider the monetary benefit to the landowner who has been granted easements and who then could get a tax break on the same property, versus the concerns of future owners who didn't get the immediate monetary benefit.

Representative Peterson asked when significant payments for conservation easements started. Mr. Houdyshell responded that he didn't know.

Mr. Houdyshell referred to a handout entitled “FWS Easement Acres” (**Document #7**). Referring to Edmonds and Faulk counties and the statewide totals, he noted that the majority of grassland easements are on crop-rated soils. He then referred to a spreadsheet detailing existing conservation easements by crop and grassland categories for Edmonds and Faulk counties (**Document #8**). He said if these two counties were assessed, as suggested in Document #6, by adjusting crop rated soils encumbered with conservation easements to a noncrop rating, both counties would lose millions in ag land valuations. As a result, these counties would have two choices: Collect less revenue or increase the levies to generate same amount revenue on less valuation in the counties.

Mr. Houdyshell said the Department of Revenue has determined that making adjustments for conservation easements will have a significant impact that would affect all taxpayers; there definitely would be some shifting, and some counties would be impacted more than others.

Representative Justin Cronin said that any changes need to be done in a fair and equitable manner across the board.

Senator Rhoden thinks that cropland in conservation easements was probably not desirable farm ground in the first place. He asked if there is a way to factor in adjustments available for that type of land per statute. Mr. Houdyshell said he doesn't know how to factor that in the Department's estimates. He's looking at the raw numbers only.

Senator Rhoden emphasized that a landowner with a conservation easement does have tools available to make documented valuation adjustments and could appeal his assessment regardless of easements.

Mr. Paul Dennert said there is a shift that is going on today because of the counties that are behind in their valuations, and that this should be considered also.

Mr. Lyle Perman said that having more than six hundred people in line for perpetual easements indicates the program is still popular with landowners. He believes that most easements in eastern South Dakota have a strong grassland component and are probably contiguous to cropland that is not the best cropland.

Mr. Houdyshell said that soil rating were taken into account when determining cropland and noncropland ratings and are reflected in the value.

Senator Rhoden said that as long as there are perpetual easements, there will be a problem and he hopes that someone will put limits on perpetual easements.

There was a discussion about how “savings captured” could be “transferred to general education”. **Senator Al Novstrup** questioned how savings from taxes not paid can be shifted. Senator Rhoden said this has been part of an ongoing discussion. He said basically the shift could be done by adjusting the Cutler/Gabriel formula with a percentage adjustment between local effort and state effort.

Mr. Curt Everson questioned the willingness of county directors of equalization to use the statutory allowed adjustments. Mr. Houdyshell said it varies; some are actively looking for places to make adjustments, while others aren't so active. His department does encourage and provide guidance to directors to make adjustment where valid. Ultimately they need to determine what works for them.

Public Testimony

Ms. Brenda Forman, representing the SD Cattlemen's Association, SD Association of Conservation Districts, SD Grasslands Coalition, SD Farm Bureau, SD Farmers Union, and the

SD Stockgrowers, testified. She said her groups favor actual use. They are requesting the task force to support a SDSU research project that would determine the impact of changing from highest and best use to actual use. She said actual use assessments will result in a shifting from cropland to noncropland and vice versus. The questions are: to whom, how much, and will it be appropriate? She said additional research, data collection, and analysis is needed.

Ms. Forman suggested Mr. Kirk Chaffee's evaluation of actual use in Meade County, as one possible research method. He used FSA information and overlaid several GIS-layer maps to create a clearer picture of the land's actual use. Mr. Chaffee had noticed that Class IV soils use can go either way. Department of Revenue tables showed Meade County had 700,000 acres of crop rated soil while NASS numbers showed only 500,000. She said these type of discrepancies need to be reconciled.

Senator Rhoden said that the Legislature would need to know the cost of such research before it would support it.

Ms. Forman said the study would involve a broad base of multiple counties, but not all sixty-six counties.

Dr. Jones, SDSU said they have not had time to look at Ms. Forman's proposal in depth. She said SDSU has a mandate to work with this task force and they want to provide the best information possible. They would be glad to come up with a proposal that would address alternatives and come up with a recommendation.

Ms. Brenda Whiting, Pennington County, SD Property Taxpayers Coalition, is supportive of HB 1097 as generally written, but requests that language that would allow ten and twenty acre parcels of land to be classified as ag, if appropriate.

Mr. Michael Held, SD Farm Bureau said they are opposed to allowing special adjustments for land encumbered with conservation easements. He feels that the landowners have already been compensated, and if years later someone purchases that land, they should be aware of the easement and negotiate a lower price for the land.

Mr. Jim Faulstich, SD Grassland Coalition, Hand County, testified. He said he hopes the task force will look at how much soil is classified as cropland by the Department of Revenue that should be classified noncrop as per USDA data. He wants to know the reasons for those discrepancies and how it was determined where the line was drawn between cropland and noncropland. He said actual use could eliminate a lot of these problems, but it should be fair. He also said that some fields have both crop and noncrop soils within the field making it difficult to efficiently crop.

Senator Rhoden agreed there is land classified as cropland that really isn't productive cropland. He said that these could be reasons for adjustments that are already in statute.

Mr. Chaffee encouraged Mr. Faulstich to investigate the online web soil survey.

Mr. Matt McCaulley, SD Corn Growers, said that easements are voluntary management decisions. His organization opposes adjustments for easements and opposes perpetual easements

Mr. Paul Lepisto, SD Izaak Walton League of America, testified that his organization is in favor of perpetual easements.

Senator Rhoden commented that the task force is not planning on drafting legislation affecting perpetual easements, but it is an issue that should be considered by interested legislators.

Mr. David Gutierrez, Jackson County rancher/farmer requested the task force to provide tax incentives for family farmers, small farmers, and young farmers. He said unless rapid property tax increases are stopped, it will hasten the end of small farmers, and help bring in industrial farming. He is

in favor of actual use assessments. He asked for statutory adjustments to allow reclassification of highly erodible crop-rated property. His image of the farmer pictured on the SD state seal is that of a farmer that is farming his own land, making a living, rearing a family, and being part of the community.

Senator Rhoden said highly erodible land is a good subject that the task force has never discussed.

Task Force Discussion

Senator Rhoden asked the task force to discuss actual use.

Mr. Perman said the proposed SDSU research study is important in that it will show what shifts may take place and the impact of those shifts.

Mr. Walt Bones agreed that a study needs to be done. He said if there are inequities and a shift happens, so be it; but the task force should continue to work towards a fair, equitable, and correct system.

Representative Peterson thinks a study would be beneficial. He asserted that ag valuation is going up greater than any shifts that may take place from reclassifications.

Mr. Everson supports an objective research study. He commented that the productivity system is being blamed when really many counties were behind in their assessments under the old market system. If the tax system is moved from highest and best use to actual use, he is concerned that actual use might then get the blame for the results of any tax shifts. He hopes any study would address these misconceptions.

Mr. Dennert thinks it's imperative to go forward with actual use legislation. He says the Appropriations Committee will require a fiscal note, so it is important to get some cost information prior to session, even if it be limited to a few counties.

Senator Rhoden asked that the cost for a SDSU research project be available by the next meeting. He also requested that the ag groups come to the next meeting with a plan to cover the upfront costs of the study; otherwise, a special appropriation is required and nothing can be done until the 2015 session.

Mr. Chaffee said from his experience in Meade County he knows it will take some time to put the research study together. If the study looks at actual use, soil ratings will come up, and he suggested class IV rated soils will be the tipping point as to whether they are rated crop or grass. He said when comparing the online web soil survey to what some of the older counties have, the difference is remarkable. As for actual use in Meade County, he thinks one part of the county would be in favor, the other would be against.

Mr. Hansen asserted that the objective of the task force is fairness. He'd like to know what percentage of the landlords share is being paid in property taxes. He said that will give a good indication of fairness. He said perhaps when it comes to the full implementation of the productivity model; we might decide that it is working pretty well.

Senator Frerichs agreed that there should be a research project on actual use.

Senator Rhoden then asked for discussion on conservation easements.

Senator Frerichs said that according to the Department of Revenue assessment changes solely based on conservation easements aren't allowed. He understands that some counties are changing the assessment from crop to noncrop based on easements, while other counties do nothing. He stated it is an issue that should be spelled out in rule or clarified in a memo to counties. Personally, he's not in favor of granting assessment changes for easements.

Representative Peterson agrees with the SD Corngrowers that the landowners have already received sufficient compensation without further adjustments for land placed in easements.

Mr. Paul Dennert said that actual use will take care of the easement situations.

Senator Rhoden then asked for a broader discussion of HB1097 from the 2014 session.

Representative Peterson asks that the Department of Revenue bring to the next meeting any proposed changes that they may recommend for the draft legislation related to HB1097.

Senator Rhoden said that perhaps a different description and criteria of what it takes for timber to qualify as ag property is needed and that that minimum acres criteria issue needs resolution.

Senator Rhoden also commented contiguous acres requirements are another issue that needs to be addressed. He has concerns with the criteria requirements in proposed HB 1097.

Mr. Everson said a lot of parties have an interest, there are many factors at play, and that it is difficult to provide a legislative direction. When proposing land use legislation, the task force is challenged to be aware what the legislation will promote and what it is trying to prevent.

Representative Julie Bartling agreed with Mr. Everson that the task force is dealing with very complicated issues that have the potential to change the way we look at traditional agriculture land.

Mr. Chaffee said there is language in the existing statute that's difficult to apply. He said to keep the following criteria simple: gross family income; and contiguous land versus platted acres versus inside or outside of corporate limits. Just set an acreage criteria amount, he advocated.

Mr. Dennert recommends the task force accept Dr. Pflueger's recommendations on landlord share and cap rate, at least until the full productivity valuation system assessments is being applied in each county. Senator Rhoden agreed that there should be no changes at this time.

Senator Rhoden said it is important to remember that the cap rate found in statute is a multiplier that was backed in to as a starting point to make sure it was revenue neutral between the ag classification and the other property classifications. The landlord share was also backed in to with the purpose of that no tax shift occur between cropland and noncropland. He said how do you take a number backed into as a multiplier and now convert it and then apply current economic factors and data and overlay it on a number designed for a different purpose? He said the landlord share is a legitimate number, and as input costs go up the task force may examine and make recommendations on the landlords share.

Staff Directives, Next Meeting Date, Adjournment

Senator Rhoden asked Mr. Baatz to draft some legislation addressing identified issues for the next meeting concerning criteria for the ag land classification and the proposed SDSU research project.

The next Task Force meeting date was set for October 27, 2014.

MR. PAUL DENNERT MOVED, SECONDED BY MR. KIRK CHAFFEE, TO ADJOURN THE MEETING. The motion prevailed unanimously on a voice vote.

The meeting was adjourned at 3:30 p.m.